SIA

Foreign Activity

An Analysis of Foreign Participation in the U.S. Securities Markets
Produced by the SIA Research Department

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Foreign Activity in U.S. Securities

"Highlights"

1. Foreign activity in U.S. equities during 88-Q3 matched both Q1's and Q2's $96 billion totals. However, Q2's turnaround to a positive net inflow accelerated further in Q3, with $814 billion of net purchases exceeding Q2's infusion by one-third.

2. The Asian (Japanese) share of foreign gross activity in U.S. equities grew from under 15% in 1984 to 40% last year (Jan. - Sept.). For the first time, this matched European gross activity, which was as high as 56% of activity in 1984. Meanwhile, the quarterly trend during 1988 was identical, with Asia's share increasing and Europe's decreasing each quarter, until Asia reached a 42% share in Q3 and Europe a smaller 37%!

3. Foreign activity in U.S. equities equaled 8% of the value of NYSE trading during 1982-85 and then, fueled from Japan, matched 10% of total NYSE activity in 1986 and 13% by 1987! Further, this growth is all the more impressive since the dollar value of all NYSE trading doubled from 1985 to 1987!

4. Total foreign activity in U.S. Treasuries rose from $784 billion in 88-Q2 to $820 billion in Q3, but net purchases were slashed in half to $12.2 billion. A drastic reduction in Japanese purchases in Q3 and a $5 billion net selloff from central banks led to the decline.

5. Foreign gross activity in U.S. corporate bonds dwindled for the second straight year, to only $85 billion in 1988 (Jan.- Sept., annualized). The $20 billion of activity in corporates in Q1 and Q2 grew to $24 billion in Q3 while net purchases held above the $6 billion level for the second straight quarter.

6. U.S. investors' purchases and sales of foreign equities is running at a $143 billion annual pace. That's 24% off 1987's record level of $189 billion, but it will be the second highest annual showing ever if the pace is maintained throughout 1988. However, net acquisitions, purchases less sales, by U.S. investor's is running at one of the lowest levels of the 1980s.

A Yen For U.S. Equities

Although foreign gross activity in U.S. equities in 88-Q3 remained flat, matching the two preceding quarters' $96 billion of gross purchases and sales, Q2's turnaround to a positive capital net flow into U.S. equities accelerated further in Q3, with $814 billion of net purchases bettering by one-third Q2's infusion of $588 billion (Exhibit 1).

After the major selloff of U.S. equities by foreigners (and everyone else, too) in 87-Q4, foreigners nibbled a bit in January, buying a nominal $32 billion net, and then resumed dumping about $400 billion net in U.S. equities during each of the next two months. April saw foreigners snap up over $1.3 billion in U.S. equities, the highest showing in six months, but only to see most of these net purchases sold back into the market in May.

EXHIBIT 1

GROSS TRANSACTIONS IN AND NET PURCHASES OF U.S. EQUITIES
($ Millions)

	Second Quarter 1988		Third Quarter 1988	
	Gross Activity	Net Purchases	Gross Activity	Net Purchases
Europe	$38,383	$ (637)	$35,915	$ (103)
Belgium-Luxembourg	2,006	151	1,567	(15)
France	2,896	(33)	2,732	(92)
Germany	2,831	2	2,582	(8)
Netherlands	1,388	(244)	1,179	(42)
Switzerland	8,984	(468)	7,939	(632)
United Kingdom	18,097	(137)	17,678	732
Canada	8,733	171	8,136	264
Latin America & Caribbean	9,634	32	9,319	527
Bermuda	1,795	31	1,533	33
Netherlands Antilles	3,244	73	2,925	37
Asia	37,807	1,063	40,742	(94)
Hong Kong	1,796	(40)	1,624	22
Japan	31,320	1,544	34,485	217
"Other Asia"*	3,340	(463)	3,709	(256)
Total All Countries	**$96,758**	**$588**	**$96,092**	**$814**

Source: U.S. Treasury

* Countries included are: Bahrain, Iran, Iraq, Kuwait, Oman, Qatar, Saudi Arabia, the United Arab Emirates.

During the summer, June through August, while U.S. investors were avoiding equities, foreigners were bottom fishing and quietly (obviously, since the markets didn't reflect any bullish sentiment) accumulated nearly $2 billion net in equities.

As 88-Q3 closed, foreign buying/selling patterns re-converged with U.S. investor sentiment -- foreign investors, like their U.S. counterparts, became net sellers during September's anemic market. Exacerbating September's poor showing was an almost complete shunning by Japanese institutions of dividend recapture programs, turning in their lowest dividend roll activity of any month so far in 1988. And, as will be discussed shortly, the sentiments of this group of investors is tantamount to what color the total offshore capital inflow/outflow picture will be painted!

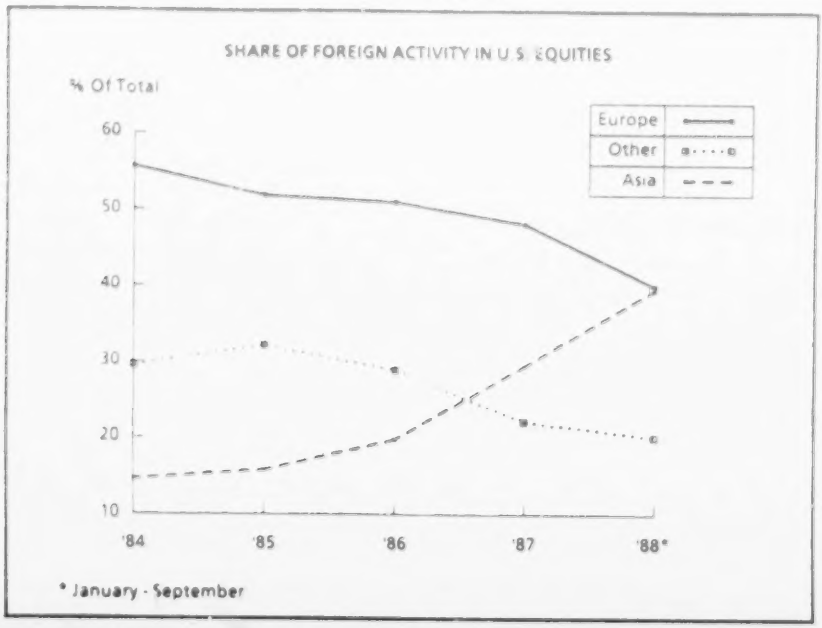
Further, since dividend rollovers rolled over and played dead for the remainder of the year, their absence portends a negative direction for foreign (read Japanese) investment in Q4.

Just how large a factor these Japanese investment patterns are becoming to capital inflows to the U.S. cannot be understated. Taking a long-term look at foreign buying patterns highlights this emerging trend.

Rising Sun's Rising Share

The explosive growth of Japanese interest in U.S. equities, both on a gross and net basis, drove the Asian share of all foreign activity from less than 15% in 1984 to 20% by 1986, 30% by 1987, and 40% last year (based on nine month results). Meanwhile, Europe's impact on the value of all foreign equity transactions fell from 56% to 40% over the same time frame. All other foreign investors' share fell from 30% to 20% over the same period (Exhibit 2).

EXHIBIT 2



This trend was reflected perfectly during 1988: Europeans accounted for 43.4% of all foreign equity transactions during Q1; 39.7% in Q2, and 37.4% in Q3. Asian investors accounted for 37.3% of the value of foreign transaction in Q1, to a virtual tie with Europeans at 37.1% in Q2 and, for the first time ever, Asia, principally Japan, exceeded Europe in activity with a record $41 billion, or 42.4% share of activity in Q3.

Meanwhile, Canadian influence, which exceeded all of Asia at the beginning of the Eighties with a 16% share of foreign equity investment, has continuously eroded and accounted for under 9% of all foreign activity in U.S. equities last year (through September).

The explosive growth of Japanese investment in the U.S., both on an aggregate basis as well as relative to other foreign investors, is all the more impressive when looking at growth in home equity markets. While Japan was rapidly expanding its activity in U.S. equities, Japanese investors were also pouring their growing money base into Japanese stocks at unprecedented rates back home. Of all equity markets, Japan grew the fastest and became the largest with a capitalization of $3 trillion at the end of 1987, above the U.S.'s second place (albeit crash-impacted) $2.2 trillion. Japan's huge, and growing, trade surplus and high saving level, simply needs many roosts beyond Tokyo's own perch.

From 1975 through 1987, the capitalization of Japan's home equities market grew 21-fold! That compares to an eight-fold increase in the U.K and a three-fold increase in the U.S. Even over a shorter span, from 1980 through 1987, Japan's equity market capitalization grew eight-fold, compared to only a doubling in the U.S. and a tripling in the U.K.

The impact Japanese investment has had on all foreign investment in the U.S. can dramatically be shown by comparing foreign gross activity to total activity on the NYSE. Past surveys have shown that foreign investment in U.S. equities is principally in high capitalization, NYSE listed stocks.

If we assume, for illustrative purposes, that all foreign activity in U.S. equities were in NYSE listed stocks, then foreign investment accounted for 8% of the value of NYSE trading during 1982-85, shot up to 10% of total activity in 1986 and to 13% by 1987! Further, this growth is all the more impressive given the dollar value of all NYSE trading doubled from 1985 to 1987!

At Your (Debt) Service!

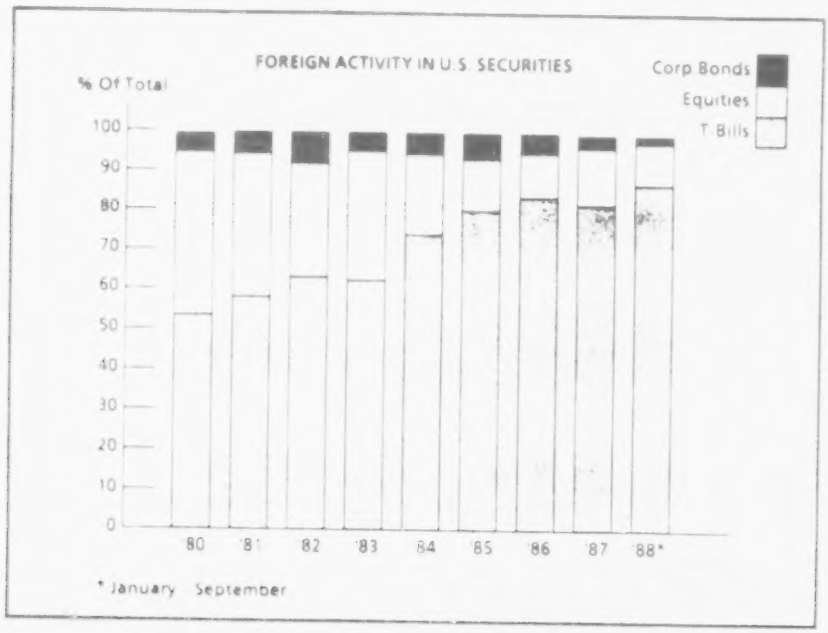
As impressive as the explosive growth in foreign activity in U.S. equities is, it pales in comparison to the insatiable appetite foreigners display for U.S. Treasuries.

In fact, gross transactions in Treasuries by foreigners increased at an average annual rate of 58% during the Eighties, double the 28% average annual growth rate in equities. Further, activity in Treasuries increased every year, going from under $100 billion in 1980 to over $3 trillion last year (based on nine month results).

Granted, central bank intervention for currency stabilizing efforts are a major factor in Treasury totals, but private institutions still account for much of the growth in the foreign appetite for U.S. Treasuries.

At the onset of the Eighties, just over half of the total activity of foreigners is U.S. securities was in Treasuries (42% of their activity was in equities and 5% in U.S. corporate bonds). An increasing overseas demand for Treasuries gradually pushed this share up to over 87% by 1988 (January through September), while equities fell to under 11% and corporate bonds to just over 2% (Exhibit 3).

EXHIBIT 3



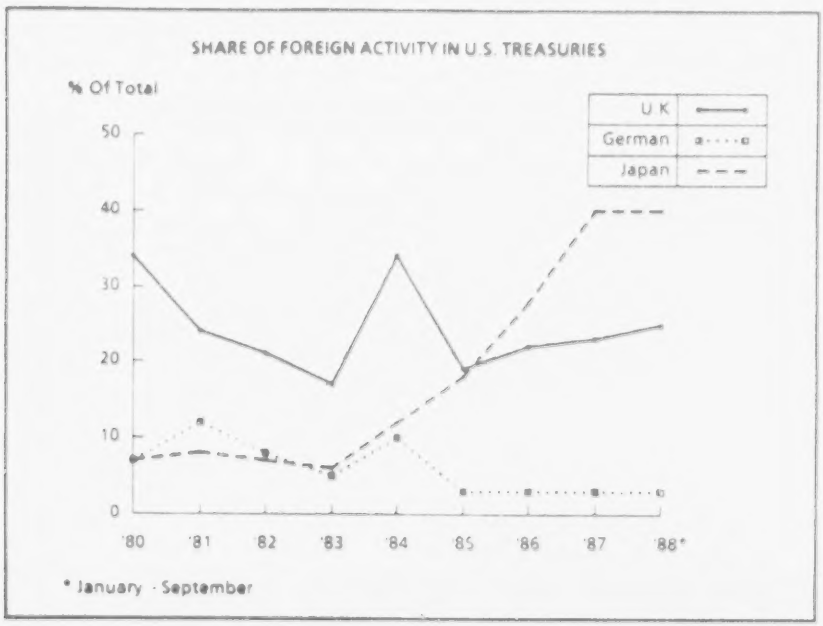
Despite the rapidly accelerating gross activity in Treasuries by foreigners in recent years, with activity about doubling in each of the years 1984 through 1986, net purchases of these bonds remained flat until 1988. From 1984 through 1987, annual net purchases of Treasuries ranged from $21-$29 billion. However, 1987's $26 billion in net purchases was entirely attributable to $31 billion of net purchases by central banks shoring up the dollar.

Sentimental Journey -- Back to Treasuries

By the first quarter of last year, foreign investor sentiment swung bullish as they purchased a net of $27 billion in Treasuries, even though about two-thirds was still derived from monetary intervention. Still, this $27 billion inflow exceeded all of 1986, and nearly matched the record net buys for a full year -- 1985's record $29 billion! Japanese enthusiasm for Treasuries fully accounted for half of all these net purchases and was a major turnaround since Japanese investors only bought, net, $1.3 billion in the preceding 12 months and during the previous year, 1986, bought a mere $3.8 billion.

On a gross activity level, Japan has become the dominant force in Treasuries beginning in 1985 (Exhibit 4), surpassing the historically dominant U.K. as the force in U.S. governments. As recently as 1984, U.K. investors accounted for one-third of the foreign market for Treasuries but fell to just 25% last year (January - September). In fact, just this month, one U.K. firm, which only recently received U.S. government dealer status from the Fed, announced its intentions to drop out of the game and give up its primary dealer status. Meanwhile, Japanese firms, which have been actively seeking, and getting, this same green light, have seen their home market investment in Treasuries climb to a 40% share of all foreign activity in U.S. Treasuries!

EXHIBIT 4



During 88-Q2, total foreign activity in Treasuries rose from $784 billion to $820 billion, but net purchases were slashed in half to $12.2 billion. Though U.S. Treasury rates were higher, expectations of further hikes kept many buyers on the sideline, abetting this 50% slash in net purchases for the quarter. Although interest rates took a temporary dip as Q2

closed, the expected upward spiral did arrive during Q3 but continued uncertainty over rate directions contributed to both a reduced gross level of activity (down to $769 billion in Q3) and a net dumping of nearly $1.4 billion in Treasuries (Exhibit 5). The outflow would have been more than twice as severe, however, if not for continued, albeit dramatically reduced, net purchases from Japan -- $1.7 billion.

EXHIBIT 5

NET FOREIGN PURCHASES OF
U.S. TREASURY NOTES AND BONDS
($ Millions)

	Full Year 1987*	First Quarter 1988*	Second Quarter 1988	Third Quarter 1988
Europe	$23,716	$13,670	$2,215	$ (3,638)
Germany	13,330	5,361	(2,585)	(6,979)
Switzerland	1,917	(427)	689	(1,062)
United Kingdom	3,975	4,029	1,667	3,233
Asia	4,488	12,156	4,718	2,969
Japan	868	12,304	3,415	1,700
"Other Asia"	(3,142)	(528)	(299)	584
Nonmonetary Int'l & Regional Organizations	(5,302)	(881)	1,971	(1,184)
Total All Countries	**$25,587**	**$26,707**	**$12,245**	**$ (1,377)**

Source: U.S. Treasury

* Revised.

More importantly, central bank action in 88-Q3 was entirely "sell dollars and buy home currencies." Over $2 billion in Treasuries were sold in these actions in August and about $1.5 billion, net, was sold in each of the following two months. This negated about $5 billion in net purchases from the foreign private sector.

U.S. Corporate Bonds

Foreign activity in U.S. corporate bonds, long the stepchild of foreign investment in U.S. securities, dwindled for the second straight year back to under $100 billion based on nine month results, annualized. These securities account for only 2% of total foreign securities activity in the U.S. (Exhibit 3), since they are more easily bought in home markets with the same brand names available in Eurobonds or Samurais.

Nonetheless, the $20 billion in activity experienced in Q1 and Q2 grew to $24 billion in Q3, and net purchases held above $6 billion for the second straight quarter (Exhibit 6).

EXHIBIT 6

GROSS TRANSACTIONS IN AND NET PURCHASES OF U.S. CORPORATE BONDS

($ Millions)

	Second Quarter 1988		Third Quarter 1988	
	Gross Activity	Net Purchases	Gross Activity	Net Purchases
Europe	$11,099	$4,379	$13,611	$3,909
Belgium-Luxembourg	447	116	631	(101)
France	468	10	597	61
Germany	1,094	522	940	114
Switzerland	951	51	880	6
United Kingdom	7,151	3,395	9,556	3,314
Asia	6,326	1,698	7,279	1,782
Japan	5,510	1,634	6,139	1,663
"Other Asia"	406	(86)	736	(71)
Total All Countries	$19,719	$6,583	$23,609	$6,070

Source: U.S. Treasury

U.K., Japanese and OPEC interest, in that order, kept the capital flows on the positive side into domestic corporates for the six months ended in September. Although interest rates were spiking upwards during this period with concern of further increases, new high yield issues, particularly from LBO deals, offered buying opportunities for foreign investors with an eye for these risk/reward issues.

U.S. Capital Still Not Seeking Exit Visas

As Exhibit 7 shows, U.S. investors have maintained their post-crash gross activity in foreign stocks at the $36 billion quarterly level. Assuming this continued pace in the fourth quarter, U.S. investors will have bought and sold $143 billion in foreign equities during 1988. That's about 24% off 1987's record level of $189 billion, but still the second highest annual showing ever, bettering 1986's previous second best level of $101 billion by 42%.

EXHIBIT 7

GROSS TRANSACTIONS IN AND NET PURCHASES OF FOREIGN STOCKS BY U.S. INVESTORS
($ Millions)

	Second Quarter 1988		Third Quarter 1988	
	Gross Activity	Net Purchases	Gross Activity	Net Purchases
Europe	$17,273	$(299)	$18,192	$1,670
France	388	162	866	236
Germany	1,279	91	1,050	154
Netherlands	865	43	1,080	(20)
Switzerland	1,235	25	1,092	62
United Kingdom	11,319	(551)	12,238	1,008
Canada	2,610	(38)	1,612	(106)
Asia	12,960	(546)	14,002	(1,112)
Japan	11,598	(444)	12,465	(1,177)
Other	2,313	(299)	2,640	4
Total All Countries	**$35,156**	**$(1,182)**	**$36,446**	**$456**

Source: U.S. Treasury

Net purchases of foreign stocks by U.S. investors is running at a mere $200 million annual pace for 1988. U.S. investors have been net buyers of foreign equities in every year during the Eighties except crash-impacted 1987, when Q4's selloff of $3.7 billion brought the annual total to a negative $1.1 billion. Discounting 1987, however, 1988's net purchase pace of $200 million (January - September, annualized) will be the lowest level of foreign equities bought by U.S. investors since 1981.

The selloff of $1.2 billion in 88-Q2 more than wiped out the $890 million of net purchases in Q1 as well as negating part of the $456 million in net buys in Q3. The net purchase of nearly $1 billion in Q1 is entirely attributable to U.S. investors' net purchases of $1 billion worth of Japanese stocks.

Interestingly, U.S. investors were net sellers of about half a billion dollars worth of U.K. equities in each of 1988's first two quarters, while the "Financial Times" all-share index

showed a steady 6% increase in stock values. Then, in the third quarter, as the market gave back most of the previous six months' gains, U.S. investors bought a net of $1 billion. Netting the selloff in Japanese stocks with U.K. purchases, the third quarter's net purchase total, albeit small, came from U.S. interest in German and French issues.

In sum, although gross activity in foreign equities by U.S. investors from January through September is running at the second highest annual level ever, portfolio shifting inter-, as well as intra-market, will leave 1988 at one of the lowest levels of the Eighties for U.S. interest in acquiring foreign equities.

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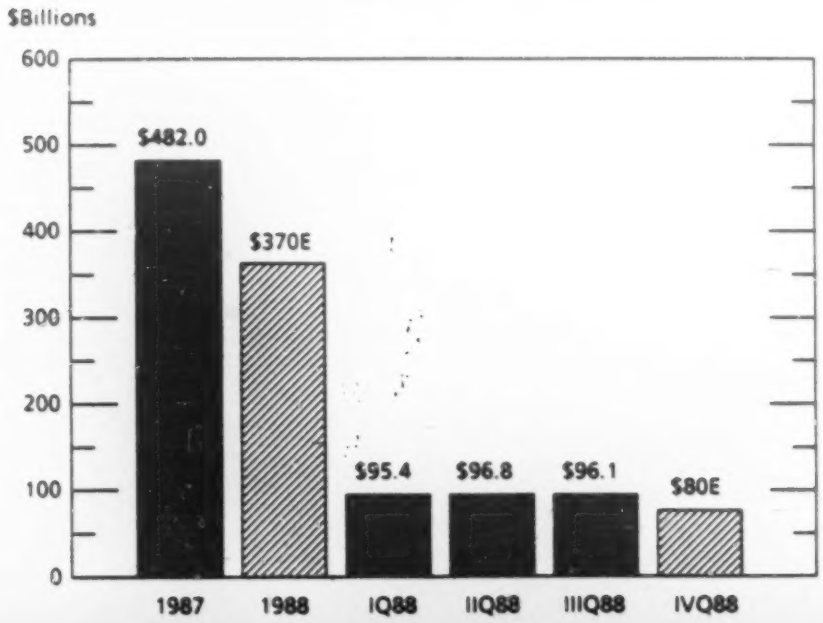
UPDATE ON FOREIGN ACTIVITY IN U.S. EQUITIES "1988"

A Good Recovery BUT...

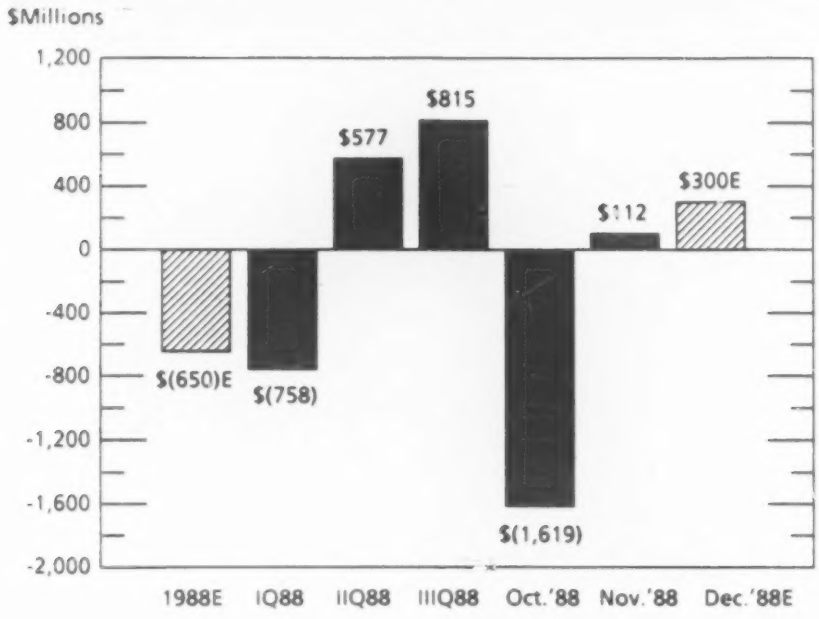
The U.S stock market staged a strong recovery, 12%-18%, from the 1987 crash, fueled largely by take-over related activity. But the steady and slow uphill climb of the U.S. stock market was not enough to convince foreigners to return to U.S. equities with any real enthusiasm. Given a 14.4% drop off in NYSE share volume, U.S. investors also were cautious in 1988. Indeed, without a 10.1% boost from dividend capture transactions, NYSE volume would have been down by more than 20% from the 1987 level.

Through the first three quarters of the year, gross foreign purchases plus gross sales of U.S. equities reached $288.4 billion, or about 59.8% of 1987's record $482.0 billion. The pace of gross transactions slowed in the fourth quarter, with

Foreign Gross Activity in U.S. Equities



Foreign Net Activity in U.S. Equities



$28.0 billion and $23.8 billion registered in October and November, respectively. Annualizing for 1988 brings foreign gross activity in U.S. equities to an estimated $365-$375 billion. For 1988, foreign gross transactions in U.S. equities missed the 1987 record by 25% or over $100 billion, but surpassed 1986's $277.5 billion by 33% or almost $100 billion.

Although the stock market trudged upward in the last quarter of the year to a modest December rally, the dollar ran into troubling times, particularly in September and October. Foreign investors were quick to move out, escalating net sales of U.S. equities from $581 million in September to $1.6 billion in October -- the largest monthly movement of the year in either direction. Some intervention to help the dollar, another 4 years of Republican leadership, and temporarily eased inflation fears saw foreign investors take a more moderate position in November -- net purchases of $112 million. The December rally most likely enticed foreign investors to up their investment, but caution remained the byword. We estimate foreign investors made net purchases of around $300 million in December.

Hence, foreign investment in U.S. equities in 1988 pales in comparison to prior years. We estimate foreign investors were net sellers of between $500-$800 million of U.S. equities. In contrast, foreign investors were net purchasers of $16.3 billion in 1987 and $18.7 billion in record-year 1986. The last time foreign investors were net sellers of U.S. equities was in 1984, when they sold $3.0 billion.

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